

# Labor Market Policy

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## Abstract

Labor market policy (LMP) refers to a set of instruments through which governments assist individuals facing difficulties in the labor market, especially but not exclusively unemployed people. The scope and nature of government activities in this area varies considerably between developed countries, and has evolved over time. Alongside an extensive literature that seeks to evaluate the effects of LMP interventions, there has been a growing interest in recent years in the determinants of this important component of modern states actions to promote the welfare of their citizens.

## Introduction

In modern societies, the majority of the working age population relies on dependent employment for access to regular income, and – arguably – for a sense of identity and full social integration. The ability to find and keep a job in a competitive labor market is thus a crucial determinant of individual welfare, while in the absence of public support all but the most transitory periods of unemployment can quickly lead to poverty as well as a range of other personal problems. A government purporting to promote the life chances of citizens cannot therefore ignore the socioeconomic risks individuals face due to the operation modern labor markets.

In the first decades after World War II, high rates of uninterrupted economic growth and a political commitment to full employment ensured that most workers in developed economies had limited exposure to the risk of prolonged unemployment. Since the early 1980s, however, lower growth and the reassertion of low inflation as the principal aim of macroeconomic policy has resulted in unemployment rising in many rich countries, reaching levels last seen in the 1930s even in periods of cyclical expansion. In parallel, rapid deindustrialization has placed those with low or obsolete skills at heightened competitive disadvantage in the labor market. It is as governments have sought to support these victims of structural economic change, and craft instruments for managing labor market risks at the individual level, that labor market policy (LMP) has become an increasingly significant field of public action.

This article introduces the field of LMP and surveys some of the most important themes in its academic study. It first defines the boundaries of LMP and describes the variety of interventions conventionally subsumed by the concept. It next discusses the evolution of LMP in developed countries, emphasizing the substantial cross-national variation in the scope of government activities in this area as well as some common trends in their development over time. A final section reviews the two major scientific approaches to LMP, namely analyses that seek to evaluate the impact of LMP and those that seek to explain its evolution.

## Defining LMP

The variety of public policies that impact on the demand or supply side of the labor market, and thus indirectly on the

extent and distribution of labor market risks, is very large. Public policies in areas as different as trade, regional development, taxation, working-time regulation, education, or child care, to name but these, might be considered labor market interventions. By convention, however, the concept of LMP has a narrower scope, limited to policies that incur direct governmental expenditure and are targeted directly on groups facing particular difficulties in the labor market.

While the targeting criterion may be useful in delimiting the field of LMP conceptually, it contradicts actual practice in most developed countries, and leads to certain anomalies in the statistical recording of LMP. For example, whenever youth unemployment has risen sharply, governments have tended to react by introducing large youth employment programs, often involving temporary subsidies for private-sector employers when hiring any person under the age of 25 years. Though such measures have a target group far broader than other LMPs, they are recorded in international data on LMP expenditure and participation on the justification that the entire demographic group can be considered as disadvantaged in the labor market. By contrast, measures that subsidize private-sector employers hiring any person below a certain wage level are excluded from these statistics on the grounds of being insufficiently targeted. This is despite the fact that the beneficiaries of the two types of measure largely overlap, each is presented in public discourse as a measure to combat youth unemployment, and they are in all probability in competition for a share of the same public budget allocation. As governments have in recent years turned increasingly to more general measures of labor cost or wage subsidization (see below), expenditure data based on conventional definitions of LMP may thus give a somewhat misleading impression of declining public support for vulnerable groups in the labor market.

Limiting the definition of LMP to interventions incurring public expenditure also carries implications. In addressing youth unemployment, for example, governments in many countries have in recent years placed as much emphasis on regulatory reforms as expenditure measures. New types of employment contract with extended probationary periods are an instance of public policies very directly addressed to the problems facing groups disadvantaged in the labor market but using other policy levers than monetary investments and incentives. Indeed, the issue of employment protection legislation (EPL), and its interaction with expenditure-based LMP, has been central to recent debates around the management of labor market risk, particularly in Europe (see below). While

there may be good intellectual grounds for excluding EPL, or minimum wage legislation, from the formal definition of LMP, it is important to acknowledge that these regulations are equally crucial institutional determinants of labor market performance.

Despite being in some senses overly restrictive, the conventional definition of LMP still encompasses a range of very different public policy instruments. EUROSTAT (2006) identifies three broad types of action, which it calls LMP 'services,' 'measures,' and 'supports.' LMP services refer essentially to the intermediation work of the public employment service (PES), including publication of vacancies and referral of jobseekers as well as more intensive case-management work with unemployed people. Also focused on facilitating transitions from one labor market status to another, LMP measures designate a series of more interventionist policy instruments, including programs involving the direct creation of additional jobs for the unemployed in the public and parapublic sectors and subsidies to private employers that seek to incentivize recruitment of disadvantaged groups. Training programs that aim to enhance the employability of disadvantaged groups through instruction in formal educational contexts and/or in workplaces are a third important type of labor market measure, a category that also includes job sharing schemes, support for unemployed individuals seeking to start their own business and specific measures of occupational rehabilitation for those with reduced work capacity due to illness or disability.

Rather differently, LMP supports provide individuals with cash transfers to compensate them financially for economic disadvantage resulting from their labor market situation. The most important type of support is provided through unemployment compensation, including both unemployment insurance (UI) benefits that are paid to eligible unemployed individuals up to a maximum duration of unemployment, and unemployment assistance (UA) benefits that are paid to those who remain unemployed thereafter or who are not eligible for UI in the first place, for example due to an inadequate work or contribution history. The UI benefits to which an individual is entitled is often related to their previous earnings in employment, while eligibility for UA benefits depends on a means test, meaning the income and assets of an individual, or their household, must be below a specified level to allow them to receive support.

Three additional types of financial compensation for disadvantaged workers are also generally considered to belong to the category of LMP supports. The first are one-off lump-sum payments that individuals may receive from public authorities (rather than from their employers) in the event of their being made redundant due to adverse economic conditions. The second are early retirement benefits, which compensate older workers assumed to have little chance of finding replacement employment for their total or partial retirement from the labor market, up to the age of their entitlement to a regular old-age pension. In some cases the payment of these benefits is made conditional on the retiree's employer hiring a replacement employee from an LMP target group such as young jobseekers. Finally, LMP supports also include measures that compensate short-time working arrangements or 'partial

unemployment' linked to a temporary downturn in a firm's economic activities as a result of cyclical or seasonal fluctuations. These policies, which are seen as a way of preventing redundancies by facilitating working-time adjustments, have been mobilized extensively in many countries in the current global economic crisis.

The categorization of LMP into services, measures, and supports offers an alternative to an older approach to classifying these policies, still favored by the Organisation for Economic Cooperation and Development (OECD), the distinction between 'active' and 'passive' LMP. The notion of active LMP maps onto the EUROSTAT categories of services and measures, and has spawned an acronym – ALMP – that is widely used in the academic and policy literature. Passive LMP, in this approach, refers to instruments that compensate individuals financially for the loss or absence of employment, in other words what EUROSTAT considers LMP supports. Though widely used, the active–passive distinction is problematic in a number of ways. Most obviously, the terms are rather loaded; from the respective synonyms of active (energetic, lively, vigorous...) and passive (flaccid, inert, submissive...), it is clear they carry very different evaluative connotations concerning the desirability of these different types of instrument, all of which are arguably important parts of a balanced LMP portfolio. If the distinction is understood to differentiate between policies that facilitate positive transitions and those that compensate negative situations, then it neglects the fact that payment of unemployment benefits itself helps to assist labor market transitions by giving jobseekers the breathing space necessary to find jobs well-matched to their skills and professional aspirations, with potentially beneficial effects for productivity levels in the economy as a whole (Clasen, 1999). Inversely, many supposedly active policies may result in labor market transitions that are far from positive, placing individuals in dead-end schemes that may be stigmatizing for the individual beneficiary and do nothing to improve their future employment prospects.

It remains the case, however, that the field of LMP covers policy instruments of a very different character. The distinction between 'entitlement' and 'discretionary' policies that is commonly used in the American budgetary process is of relevance here. Any individual meeting the existing eligibility requirements has a legal entitlement or right – enforceable in court if necessary – to UI or UA. By contrast, receiving LMP services, participating in measures or benefiting from other supports, such as early retirement measures, is not usually an individual entitlement. These other types of LMPs are thus generally discretionary measures, where public expenditure determines the scope of individual participation and not vice versa. As such, governments are far more likely to make frequent adjustments to discretionary LMP than they do to unemployment benefits. The peculiar nature of unemployment benefits as entitlement programs also explains why they have more often than other LMPs been considered part of social policy, something reflected in some countries in them being separately administered from LMP measures and services. But understandings of the respective functions of, and appropriate interactions between, different LMPs have also evolved over time in developed countries, with changing socioeconomic conditions and political priorities.